

Statement for the Arizona Citizens Finance Review Commission

By

Raymond C. Scheppach

and

Harley T. Duncan

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Raymond C. Scheppach, is the executive director of the National Governors Association and Harley T. Duncan is the executive director of the Federation of Tax Administrators.

The current fiscal crisis in states is unprecedented and reflects the cumulative impact of two long-run structural problems, i.e., exploding health care costs and a deteriorating tax base and the short-run cyclical downturn with its attendant slowing of all revenue growth and the virtual collapse of capital gains and corporate tax revenues. The structural problems were camouflaged by the phenomenal economic growth of the late 1990s but became part of the perfect storm in 2002 when state revenues declined by 6.3 percent for the only year over year decline witnessed since the Second World War. The \$50 billion shortfall for last year was closed by significant budget cuts and drawdown from “rainy day” funds as well as some minor tax increases. Unfortunately, states are facing another shortfall of \$40 to \$50 billion for this current fiscal year and the preliminary projections for fiscal year 2004 are in the \$60 to \$70 billion range.

Long-Run Structural Problems

The two structural problems are the most troubling since they will leave states in fiscal stress even after economic recovery.

- A deteriorating tax base – States currently have tax structures that were designed around the manufacturing and retailing economy of the late 1950’s, not the service-oriented, international, technology driven economy of the 21st century. State revenue systems, as a whole, are not fully responsive to economic growth, and as time passes, they will have difficulty providing an adequate supply of revenue to meet state expenditure demands. State sales taxes, which represent one-third of state taxes on a national basis, are deteriorating for two primary reasons. First, states generally tax transactions involving the sale of goods and not service transactions that represent most of the growth in the economy. Second, because of a U.S. Supreme Court decision, states may not compel many out-of state-sellers of internet or mail order goods to collect sales and use taxes. The growth in these sales has been dramatic over the last decade, and economists now estimate that the revenue losses are now about \$10 billion and could approach \$20 billion by 2006. Similarly, corporate tax revenues have dropped

from about 9 percent of total taxes in 1980 to less than 6 percent in 2001, due to both the explosion of state tax incentives aimed at promoting growth and investment as well as corporations becoming more sophisticated in the use of planning techniques to minimize their tax burden. Even the individual income tax, which has become the largest source of state tax revenue due to the rapid growth of the late 1990's is exposed to some risks, including its relationship to the federal income tax and increasing difficulties in insuring full compliance.

It is also true that some states cut taxes during the boom period too much and, therefore, added to their own structural problem. Arizona, for example, made significant reductions in sales, individual, and corporate income as well as property taxes over the 1993-2002 period. Revenue losses during an economic slow down may be much higher than originally estimated during a boom period. This most likely aggravated the situation in Arizona.

- Explosion of health care spending – On the spending side of the ledger, health care represents about 30 percent of the average state budget. Medicaid alone represents 20 percent of this cost. Total health care costs are growing at 13 percent this year, which follows an 11 percent increase last year. The spiraling costs of health care are a national problem leaving few options available to states to control costs – particularly given the political difficulties with reducing benefits and eligibility for Medicaid recipients.

Few Americans understand that Medicaid is now larger than Medicare in terms of the number of people covered—44 million vs. 40 million, and in total spending—\$230 billion vs. \$215 billion. Medicaid eligibility is also growing twice as fast as Medicare. The high costs of long-term care and the cost to serve low-income individuals who are enrolled in both Medicaid and Medicare, the so-called “dual-eligibles,” adds to the problems. These “dual-eligibles” represent one-third of the total cost of Medicaid and is due primarily to the fact that the federal government has shifted appropriate Medicare costs to Medicaid. Specifically, these include the premiums, co-payments, deductibles for low-income Medicare recipients, as well as the drug benefits. In addition, a major cost for Medicaid is the long-term care or nursing home costs which should also be a

more appropriate Medicare expenditure. Medicaid now pays for about 50 percent of all nursing home costs in the United States. Unfortunately, exploding health care costs are a national problem as states have very few options to control costs. With the exception of reducing reimbursement rates, states can only reduce benefits and eligibility.

The Cyclical Problem

The slowing of the economy over the last two years was reflected in a slowing of all state revenues. More importantly, however, there was a virtual collapse of capital gains tax revenues and corporate tax revenues which fell 30 percent in the fourth quarter of 2001. These were due to the collapse of corporate profits, along with the explosion in the use of stock options and the virtual collapse of stock market and capital gains tax revenues. Unfortunately, even after the economy recovers there will be a lag in time when states will witness a return to revenue growth and even at that time the two structural problems will continue to overwhelm state budgets.

Realigning State Expenditures and Revenue Paths

Unlike previous periods of fiscal distress, the current one is less due to the recent economic downturn and more due to long-run structural problems such as a deteriorating tax base and an explosion of health care costs. For this reason, the depth and breadth of the problem is historically unprecedented and unfortunately it will take states at least 3-5 years to realign their expenditure and revenue paths. This also assumes that the federal government works with the states to reform Medicaid.

For the 25 newly elected governors this will be an almost impossible task as most have inherited budget shortfalls of 5-15 percent with almost no time to develop comprehensive long-run cost-effective policies given their balanced budget requirements and the fact that legislative sessions will begin within several weeks of the time that they are inaugurated. Most will be forced to adopt emergency type short-run spending and tax decisions to meet the balanced budget requirements. However, over the next several years all

governors will “step back” and reevaluate their long-run strategies. In order for states to return to fiscal stability they must:

- 1) restructure state government;
- 2) reform state tax systems; and
- 3) work with the federal government to reform Medicaid.

Restructure State Government

Over the next two years many governors will be reevaluating state government’s core services, efficiency, and organizational structure. Both citizens and the business community will often participate in this process, since both have a stake in the outcome.

Citizens must help identify government’s core functions and decide how much they are willing to pay for the services. In addition, they must help define the measures by which government will be held accountable. In today’s internet age, the efficiency and responsiveness of government is often measured against the ease of making an online transaction—and generally government needs improvement.

Likewise, the private sector will need to participate in the redesign of government to help states re-align their business regulation and tax systems with today’s changing economy. Moreover, because state government is the largest financial supporter of education and training in the nation, the business community must collaborate in developing a fair and efficient revenue system that supports these services.

Over the last twenty years state economies have changed dramatically due to an explosion of technology, globalization, and deregulation. Together, these forces have brought about a “new economy” characterized by different sources of wealth, corporate interdependence, dynamic markets, consumer choice, and investment needs. Governors will be reengineering state government and developing pro-growth strategies. In general, four broad strategies will likely emerge over the next several years:

- Governors will begin a process to re-evaluate the core services that government provides to determine which are most important and necessary to the state. Citizens will need to fully participate in this review with the understanding that choices will need to be made and some services terminated.
- Governors will re-engineer state government to become more flexible, adaptable, consumer-oriented, and performance-driven. This will include focusing on results, increasing accountability, using technology wisely, and examining service delivery options such as privatization.
- Governors will begin re-allocating strategic investments to focus on building the intellectual and physical infrastructure needed in the new economy. This will include a more cost-effective allocation of funds for education and training as well as infrastructure. For example, states may move investment into early childhood given the higher long-run benefit relative to other education programs.
- Governors will begin reshaping the economic environment to facilitate business expansion and eliminate market distortions caused by outmoded taxes and regulations. This includes revising tax systems, simplifying regulations, refocusing research and development on economic outcomes and commercialization, and increasing access to venture capital. This should be done in full participation with the business community.

While these changes will be extremely painful and difficult for state government, the result will be a more streamlined and efficient state government in the delivery of services. It will also produce a state government that regulates and taxes businesses and individuals in a fairer, more efficient manner. Overall, a stronger public-private partnership could emerge in states as the pro-economic growth strategies are developed and implemented, leading to increased public and private sector productivity. Fiscal crisis is extremely difficult, but it is also an opportunity to re-invent state government. The structure, organization, types of services provided, amount of privatization, and use of technology will be vastly different in just a few years.

Reform State Tax Systems

The combination of the cyclical downturn in state tax receipts, coupled with the increasing visibility of various structural issues will lead many states to undertake a thorough examination of their state and local tax structure over the next few years. Already, citizen-business-government advisory and review groups have been at work in Indiana, Nevada, North Carolina and Washington State among others. Such reviews will become more commonplace.

Overall Principles. In reviewing a state's tax system, it will be important to evaluate that system against a set of commonly accepted criteria for a high-quality state and local revenue system as well as to address specific issues within each of the major taxes. The characteristics of a high-quality tax system that are commonly used include:

- *Adequacy* – The tax system must produce sufficient revenues to meet the expenditure requirements of state and local governments over time. This requires that the system be applied to broad areas of economic activity and reflect the underlying state economy as well as be able to keep pace with changes in the economy.
- *Stability* – The tax system should be reasonably balanced among the major revenue sources so as to promote stability during economic cycles and to avoid disincentives that might arise from over-reliance on certain tax sources.
- *Equity* – The impact of the tax system should be assessed from a standpoint of fairness and equity. While there is no magical standard of what constitutes a “fair and equitable” tax system, the system should, to the extent possible, treat similar economic activity and similar taxpayers in a similar fashion, i.e., horizontal equity. In addition, distribution of the burden of the tax system should reflect to some degree the ability to pay principle.
- *Neutrality* – The tax system should strive to the maximum extent possible to treat various types and means of production, consumption, income generation and economic activity in a consistent and neutral fashion so as to avoid favoring one type of activity over another and introducing distortions into economic decision making.

- *Administration* – The tax system should be designed so that it can be administered in an efficient, yet effective, manner. It should minimize intrusion into private economic affairs, but promote maximum voluntary compliance with the tax law.
- *Economic Vitality* – Taken as a whole, the tax system should produce a stable fiscal environment that fosters economic growth, treats all types of economic activity in a neutral manner and minimizes disincentives to growth and investment. The system should also be consistent with the tax structures of other states so as to minimize any disincentives for investment in the state.

These criteria, of course, often compete with one another in that pursuit of one goal may frustrate another. Neither do they lead to any single, simple answer as to what constitutes the best state and local tax system. They should, however, serve as useful guideposts in evaluating issues and potential changes within any individual tax and in evaluating the state and local system as a whole.

Sales and Use Tax. Forty-five states and the D.C. employ a retail sales and use tax. In 2000, sales and use taxes accounted for about one-third of state tax revenues nationally. In addition, local governments in about 30 states also make use of the sales tax; it accounted for about 25 percent of all state and local tax revenues in 2000. Arizona relies somewhat more extensively on the sales tax than is the norm. In 2000, the Transaction Privilege Tax accounted for about 45 percent of Arizona state tax revenues and 35 percent of state and local tax revenues.¹

Taxation of Services. As noted earlier, the sales tax base has been subject to substantial erosion over time from at least two sources. First, sales taxes have traditionally been applied primarily to the sale of goods as opposed to transactions involving the sale of services. Services, of course, have been the most rapidly growing sector of the U.S. economy for some time; they now constitute about 60 percent of personal consumption expenditures in the U.S. As a result, the traditional state and local

¹ Appendix A (attached) provides more information on the distribution of Arizona state and local revenues in comparison to surrounding states and the U.S. as a whole.

sales tax is being applied to a shrinking proportion of economic activity and the overall elasticity of the system has declined. This shifting tax base is at least partially responsible for an increase in the median state sales tax rate.

States can be generally divided into three categories with respect to the sales taxation of services:²

- Three states – Hawaii, New Mexico and South Dakota – tax most categories of service transactions. The sales tax imposition statutes in these states are written such that the tax is imposed on all service transactions unless specifically excluded or exempted from the tax. Each of these states taxes in excess of 140 of the 164 enumerated service transactions covered in the FTA report.
- A second group of 14 states – Arkansas, Connecticut, D.C., Florida, Iowa, Kansas, Minnesota, Mississippi, New York, Tennessee, Texas, Washington, Wisconsin and Wyoming – tax a relatively extensive list of enumerated services (sixty or more of the 164 services.) These states widely tax utility services, admissions/amusements, and labor services involved in the fabrication, repair and installation of tangible personal property. These states do not tax professional services (e.g., legal, accounting and engineering services. Within the group, Connecticut, Iowa and Texas set themselves apart by taxing personal and business services to a greater degree than the others, and Connecticut and Texas tax computer services more extensively than the others.
- The remaining 29 states (including Arizona) include comparatively fewer than sixty services in the tax base, excluding in some instances even the more commonly taxed utilities and admissions/amusements. Arizona taxes just under the admittedly arbitrary cut-off of sixty services while over 1/2 of the states in this category tax fewer than 30 services. Interestingly, however, Arizona taxes relatively few labor and repair services and a greater than average number of

² Information is drawn primarily from a report by the Federation of Tax Administrators entitled “Sales Taxation of Services: 1996 Update.” This report contains an itemization of the manner in which each state taxes each of 164 types of services as well as a summary discussion of the topic. While the report is

“Other Services” which is an amalgamation of certain construction, mining, transportation, storage and leasing services. There are 24 states that tax fewer than 10 of the 19 enumerated labor and repair services.

The table below provides more detail on the taxation of services in Arizona compared to states in the aggregate.

Category	No. of Services in Category	Taxed by Arizona	Taxed by Median State
Utilities	16	12	10
Personal Services	20	2	6
Business Services	34	5	7
Computer Services	6	1	2
Admissions and Amusements	14	11	10
Professional Services	8	0	0
Fabrication, Repair & Installation	19	2	12
Other Services	47	24	9
Total	164	57	56

In short, Arizona is effectively in the middle of all states in terms of the degree to which it taxes services. It is noticeably below the norm for all states in the taxation of fabrication, repair and installation labor services.

Extension of the sales tax to various types of service transactions raises a variety of tax policy and practical implications depending on the category of services being considered. While such taxation will generally promote neutrality among types of consumption and minimize distortions in consumer choices, taxation of certain business inputs can raise issues of pyramiding or cascading and discrimination against smaller firms. In addition, taxation of some business services may have competitive issues associated with them,

somewhat dated, the landscape has not changed significantly since its publication, particularly as to general trends in the sales taxation of services.

and the taxation of certain professional services in particular raises some difficult administrative issues.³

Remote Sales. The second source of pressure on the state sales tax base is the continued rapid growth in remote sales. The U.S. Supreme Court has held that states may not compel a seller that has no physical presence in the state to collect state and local sales and use taxes on goods and services sold to in-state residents. While tax is still owed on these transactions, compliance is minimal on transactions involving individuals (as opposed to purchases by businesses.) Estimates are that the uncollected state and local tax on remote sales is approaching \$10 billion nationally in 2003; this translates to a figure of \$185 million for Arizona.⁴

The primary reason the Court has prevented states from being able to require remote sellers to collect tax on sales into the state is the complexity a multi-state seller would face in complying with the various state and local sales taxes.⁵ The complexity arises from the varying tax base differs in each state, determination of the appropriate state and local tax rate, and the paperwork involved in complying with the tax in 45 states.

To address this complexity, states have for the past 2 years been working with the retail industry through the Streamlined Sales Tax Project to devise methods of simplifying administration of the sales and use tax while still preserving essential state prerogatives for determining important elements of state tax policy. The primary simplification recommendations include uniform definitions for various aspects of the sales tax, state administration of all state and local sales and use taxes, requirements on states to provide tax rate information to sellers, simplified exemption processing, and uniform returns, remittances and registration, among other things. These recommendations are

³ For a more complete discussion, see “The Song Remains the Same,” State Policy Reports, Vol. 20, #22, November 2002.

⁴ Donald Bruce and William F. Fox, “E-Commerce in the Context of a Declining State Sales Tax Base,” Knoxville, Tennessee, February 2000.

⁵ See *National Bellas Hess v. Illinois Department of Revenue* (1967) and *Quill Corp. v. Heitkamp, North Dakota Tax Commissioner* (1992).

incorporated in the Interstate Sales and Use Tax Agreement,⁶ and a number of states will be considering legislation to implement the recommendations this session. Once the agreement is operative among a sufficient number of states, the effort will be to secure an endorsement from the U.S. Congress that would authorize those states adopting the interstate agreement to require remote sellers to collect tax on goods and services sold into a state, regardless of whether they had a physical presence in the state.

State Administration. Arizona is one of four states in which a significant number of local governments independently administer their own sales and use tax. Multistate retailers contend that such local administration imposes substantial compliance burdens on them, often citing the differing state and local tax bases, differing rates, difficulty in obtaining adequate information, multiple audits, inefficient administrative appeals systems and excessive paperwork as their primary concerns. Despite the steps Arizona has taken through the Municipal Tax Code and other vehicles to insure uniformity among local governments and to ease local administration, multistate sellers still find it to be a burdensome system. A key feature of the Streamlined Sale Tax recommendations is that there be central administration of all state and local sales and use taxes. Arizona will likely need to deal with the manner in which it desires to configure its sales and use tax administration in the near future.

Tax Expenditures. The Arizona Transaction Privilege Tax, like the sales tax base in most states, probably includes a wide range of exempt purchases and exempt sales that were designed to promote one form of worth cause or another. While each such exclusion may have merit and have been well intended, the cumulative effect of such tax expenditures over time is to erode the tax base and to introduce distortions and inequities into the system (i.e., similar transactions or taxpayers are treated differently). A number of states are likely to undertake a thorough review of their sales tax expenditures in the near future.

⁶ See <http://www.streamlinedsalestax.org>.

Corporation Income Tax. The corporation income tax has been characterized in recent years by increased volatility and continued erosion of the base. Its relative contribution to state tax receipts has declined by 30-40 percent over the last 15 years; it now accounts for less than 6 percent of state taxes. This erosion is attributable to several factors: (1) the exploding use of pass-through entities (partnerships, limited liability companies and partnerships, etc.) as a form of business as opposed to the traditional “C corporation;”⁷ (2) the expanded use of tax planning techniques to shelter income from state and federal taxation; and (3) a proliferation of state tax incentives designed to promote economic growth and investment. In 2001, the corporation income tax accounted for about 6.4 percent of Arizona state tax revenues, placing it somewhat above the national average. An evaluation of the corporation income tax will entail several considerations.

Tax Planning. The corporate tax base of many states has been riddled by the use of a variety of tax planning mechanisms in which income is legally shifted among related entities until it ends up being subject to tax in a low-tax no-tax state. The Arizona tax is less susceptible to such manipulation because the state (along with somewhat less than half of the corporate income tax states) employs a concept termed “combined reporting” or “unitary taxation” in which related entities that operate effectively as a single business are treated as a single business for tax purposes. This substantially minimizes the ability to manipulate and shift the tax base on a domestic basis. The same planning techniques are being used on an international basis to move income outside the reach of federal and state income taxes by moving the income into off-shore entities. Effectively, dealing with this issue will require cooperation and work with the Internal Revenue Service as well as other states.

Tax Incentives. Arizona, like nearly every other state, has likely adopted a variety of corporation tax credits, deductions and exemptions designed to promote growth and investment in the state. Such programs should be subject to periodic evaluation to

⁷ Income of pass-through entities is taxed at the individual level, rather than the entity level. This, too, however raises issues that are addressed below.

determine if they have been effective in actually stimulating new investment, are inadvertently and inappropriately discriminating among types of economic activity, can be accomplished in other more direct means, and whether they continue to be appropriate components of the state tax code. Nebraska and North Carolina have recently reviewed their state incentive programs, and Indiana has implemented a program to recapture benefits conferred if projected or promised job gains and investment levels are not met.

Alternative Tax Base. Several states (e.g., Washington State and West Virginia) have considered changing the nature of the primary state business tax from one based on net income to one based on “value added.” That is the base shifts from “money earned” to one that is based more on economic activity conducted in the state. The Michigan Single Business Tax and the New Hampshire Business Enterprise Tax are examples of a value-added based business tax. A value added tax will be much more stable in terms of its yield than a net income tax, and most observers consider it to be more neutral among types of business activity than a net income tax. Concerns expressed about such taxes generally revolve around the potential impact on small businesses and the fact that a tax liability exists even if the business is not a profitable one.

Individual Income Tax. The personal income tax has been both the savior and the demon in state tax structures in recent years. Throughout most of the decade of the 1990’s, it was the fastest growing state tax source and was a major contributor to the boom years that state governments enjoyed. Over the last 12-18 months, however, it has been a primary factor in the fiscal crisis now facing states. The unanticipated collapse in capital gains and stock option income that had fueled much of the growth in the late 1990’s, coupled with a customary slowing due to the recession, caused income tax receipts to run 10-15 percent below the levels of a year earlier for the first two quarters of 2002.

Nationally, personal income taxes accounted for about 37 percent of state tax revenues in 2001, having increased from about 30 percent a decade or so ago. The individual income tax was the largest single state tax source in 2001. In Arizona, the personal income tax

accounts for a smaller percentage of the state tax mix. In 2001, personal income tax comprised about 27 percent of Arizona state tax revenues.

Overall, the personal income tax is probably the healthiest of any state tax source. Most states conform their tax largely to the federal income tax base that provides a reasonably broad definition of income as a starting point. In addition, states have generally minimized subtractions from this base and employ some modestly graduated rates so that the tax is reasonably elastic with respect to income, at least compared to other state tax sources. Nonetheless, there are certain issues which should be addressed.

Federal Conformity. Arizona, like most other income tax states, conforms its income tax to the federal income tax, beginning the state tax computation with federal adjusted gross income. The arguments for conforming to the federal income tax in terms of taxpayer ease and promoting compliance are persuasive. Nonetheless, federal conformity does expose the state to certain risks if the federal government makes substantial changes to the federal tax that flow through to the states. Such changes can disrupt the fiscal planning of states as was the case with the bonus depreciation provisions adopted by Congress in 2002.

Arizona, however, manages this risk in a reasonable way by conforming to the federal code as of a particular date. This prevents federal changes from automatically affecting state revenues and gives the state time to evaluate the impact of the change on state revenues as well as the potential impact on taxpayers and compliance if the state were to choose not to conform to the federal change.

Pass-through Compliance. As noted earlier, the use of partnerships and various limited liability flow-through entities as vehicles for conducting business operations has exploded in recent years. Under federal and Arizona law, such entities are not themselves subject to tax; instead, the income is subjected to tax under the personal income tax when it is passed through to the individual shareholder. In and of itself, these arrangements create no particular issues for states because nonresident shareholders are

subject to tax on income arising from operations of the entity operating in Arizona, so the potential for income shifting, etc. is minimized.

The issue is that tax compliance systems at the federal and state level have not kept pace with the use of the flow-through entities. It is not uncommon for several entities to be involved in a single operation or transaction with income flowing through several layers before it reaches the ultimate shareholder. By and large, states and the Internal Revenue Service have not developed the information systems to monitor and match the income flowing through these multiple entities on a systematic and thorough basis. Thus, compliance cannot be assured. Several states are beginning to devote resources to the flow-through compliance issue (Alabama and California), and the IRS is beginning to address the issue as well. There are probably lessons for all states in these exercises.

Work with the Federal Government to Reform Medicaid

Since Medicaid is a state-federal partnership, it can only be reformed by Congress working with governors. Given that the existing law is quite perspective, states have little flexibility to control costs. For mandatory populations, which often represent 55 percent of the total state costs, there are few policy options for states. While there are more options for the optional populations most fall in three categories of reducing reimbursement rates or cutting benefits or reducing eligible populations. Unfortunately, broader reforms will have to be done over time. Essentially, the federal government will have to pick up some combination of long-term care or the cost of dual eligibles over a ten year transition period.

Appendix A

Arizona State and Local Taxes: Comparison with Other States

State Taxes

Compared to other states and most surrounding states, the Arizona state tax structure is substantially more reliant on the general sales tax (Transaction Privilege Tax) than is the norm. As shown in Figure 1, Arizona derives over 45 percent of all state tax revenue from the retail sales tax, compared to about 32 percent for all states. Within the region, only Nevada generates a greater proportion of revenues from the sales tax; the Arizona total is 10 percentage points or more higher than the other states in the area with the exception of New Mexico.

Conversely, Arizona generates a significantly smaller proportion of state taxes from the individual income tax than other states. Nationally, states generate about 37 percent of their taxes from individual income taxes, compared to a level of 27 percent in Arizona. Within the region, the Arizona income tax total is lower than the other states except New Mexico and Nevada that does not have an income tax.

As to other state tax sources, Arizona resembles other states nationally with selective sales (product-specific excise taxes (e.g., cigarettes, motor fuel)) generating a little over 10 percent of revenues and corporate income taxes generating about 6 percent. Within the region, New Mexico relies more extensively on “other taxes” (i.e., severance taxes) and Nevada relies more extensively on both selective sales and other taxes (which both derive from the entertainment/gambling sector of its economy). In California, the corporate income tax raises about 7.6 percent of all state tax revenues.

State and Local Taxes

When local taxes are considered in combination with state levies, Arizona is shown to still rely more extensively on general sales taxes than is the norm among all states. (See Figure 2.) Arizona generates 36.4 percent of all taxes from the sales tax compared to slightly less than 25 percent on a national basis. The Arizona level is higher than all states in the region other than New Mexico.

As with state taxes, Arizona relies less extensively on individual income taxes than state and local governments nationally. Arizona generates only 17 percent of state and local tax revenues from individual income taxes compared to about one-quarter on a national basis. Within the region, all other states (except Nevada) generate a greater proportion of revenues from individual income taxes than Arizona. One-third of all California tax revenues are generated from the individual income tax.

Figure 1
State Tax Revenue
By Source - FY 2001

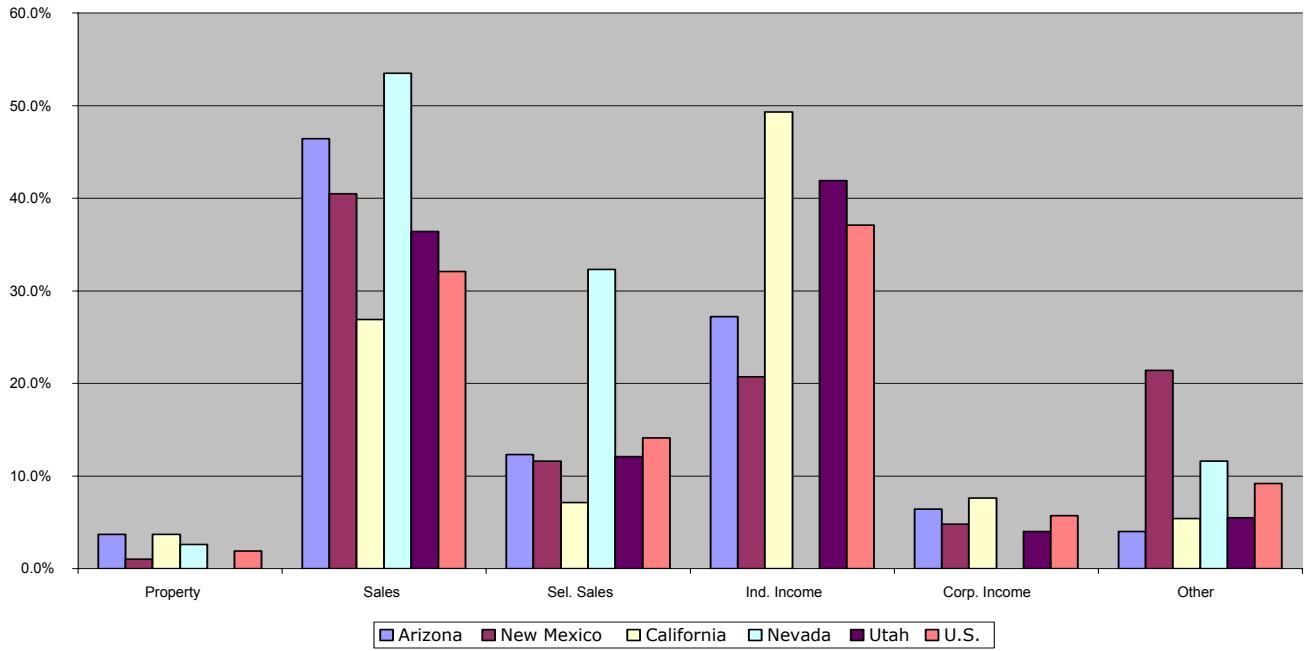
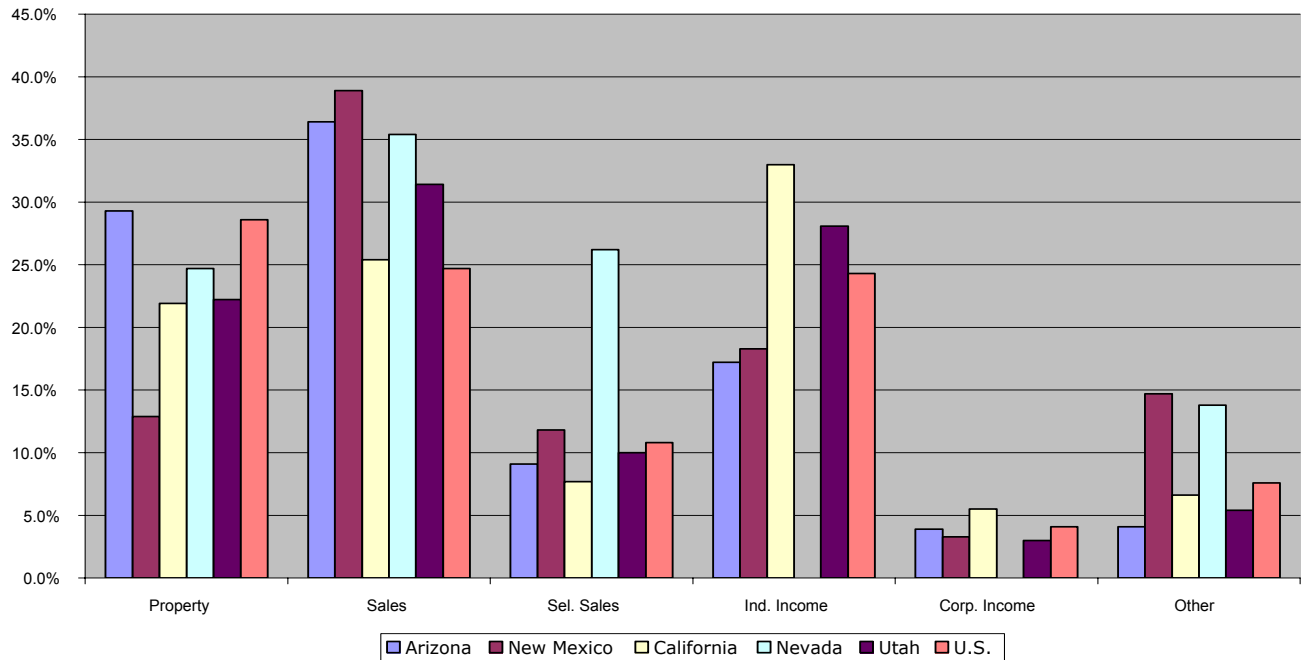


Figure 2
State and Local Tax Revenue
By Source - FY 2000



The other notable feature at the state and local level is that property taxes account for somewhat less than 30 percent of state and local taxes in Arizona, a figure that is essentially on a par with all states nationally. Within the region, however, Arizona ranks at the top in terms of the proportion of state and local taxes generated from property taxes.

State and Tax Burdens

As shown in the tables below, the Arizona state and local tax burden, in the aggregate, would not be considered high or out-of-line when compared with other states. In FY 2000, Arizona state and local taxes totaled 11.2 percent of personal income, the same level as the average for all states. Arizona ranks 37th among all states in terms of state and local taxes per capita. When only state taxes are considered, Arizona ranks 30th in terms of taxes as a percent of personal income (6.2 percent) and 42nd on a state taxes per capita basis.

The lower rankings on a state vs. state and local basis indicate that Arizona relies on local government revenues to a somewhat greater extent than states on average. Likewise, the fact that Arizona ranks lower when taxes are measured on a per capita basis than when they are measured relative to personal income indicates that the per capita personal income in the state lags the national average somewhat.

State and Local Taxes – FY 2000				
	Personal Income		Per Capita	
	Percent	Rank	Amount	Rank
Arizona	11.2%	22	\$2,599	37
New Mexico	12.7%	6	\$2,639	34
California	12.0%	10	\$3,545	8
Nevada	10.5%	42	\$2,915	24
Utah	11.9%	12	\$2,630	35
U.S.	11.2%		\$3,100	

State Taxes – FY 2001				
	Personal Income		Per Capita	
	Percent	Rank	Amount	Rank
Arizona	6.4%	30	\$1,593	42
New Mexico	9.9%	2	\$2,188	13
California	8.2%	10	\$2,622	6
Nevada	6.3%	31	\$1,820	30
Utah	7.6%	16	\$1,790	31
U.S.	6.7%		\$1,969	